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C O N F I D E N T I A L SECTION 01 OF 02 LILONGWE 000406

SIPDIS

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E.O. 12958: DECL: 05/12/2015
TAGS: EFIN EINV ECON MI
SUBJECT: IMF ON MALAWI: STRONG PERFORMANCE, BUT RISK AHEAD

REF: LILONGWE 198

Classified By: EconOff W. Taliaferro for reasons 1.4 b and d

## SUMMARY

¶1. (C) Following a recent visit from the IMF's country team, the Resident Representative confirms that fiscal performance was strong in the last quarter, despite much weaker than expected donor inflows. The IMF and GOM have reached a tentative agreement for a new Poverty Reduction and Growth Facility (PRGF), but IMF will not finalize the program until the food situation, and GOM's response to it, becomes clearer. The ResRep expressed approval of recent loosening of the exchange rate and predicts a return to a more flexible exchange rate policy. IMF's approach is helping the finance ministry and donors keep some fiscal discipline during a food crisis year. End summary.

## STRONG PERFORMANCE--MAYBE TOO STRONG

¶2. (C) As reflected in the IMF's recent press release on Malawi, its latest review under the Staff-Monitored Program showed very strong performance through the end of March. This is especially impressive given that some $22 million in payments from the EU and the African Development Bank have slipped at least to the current quarter. IMF Resident Representative Thomas Baunsgaard recently told us that the GOM was able to hit its quantitative targets mainly by going after a series of one-off revenue opportunities. He expressed mild concern that the GOM had clawed forward too aggressively, creating the possibility of a shortfall in the current period. While the team would have preferred to see small slippage against the quantitative targets, it sees dogged determination by the GOM to hit the targets every time. The basis of Malawi's strong fiscal performance continues to be its containment of expenditures, particularly in the face of weak donor inflows.

## FOOD CRISIS COMPLICATES CLOSURE ON PRGF

¶3. (C) The IMF has reached an agreement on a PRGF program, but the staff intends to hold back the program pending clarification of the extent of the food crisis. The Malawi Vulnerability Assessment Committee report, considered to be the only reliable estimate, is due out at the end of this month; preliminary numbers show humanitarian relief needs may be upwards of 150,000 metric tons. IMF wants to hold off signing a new program until it is clear the GOM will not have to revise its intervention upward. Baunsgaard said a program is likely to go to the board late June or early July.

¶4. (SBU) Asked about a worst-case food scenario, Baunsgaard said a large intervention with weak donor support would have two implications: increased domestic borrowing and a strain on foreign currency reserves. Though Malawi has too much domestic debt (about 23 percent of GDP), an intervention of, say, $25 million would increase the debt stock by only 5 percent--a sustainable increase, though not desirable. Foreign currency reserves, however, remain a major constraint to importing food. With about $90 million (1.4 months of cover) in reserves, a major intervention could bring reserves to a dangerously low level. If a forex crisis appears imminent, Baunsgaard said, some emergency action by IMF and World Bank may be possible, depending on the size of the shortfall. At this point, though, neither the extent of the crisis nor the response by donors or the GOM is clear. The only certainties are that a food crisis of significant proportions is close at hand, and that it will strain Malawi's already-strained budget even further.

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## MORE FLEXIBLE EXCHANGE RATE

¶5. (C) While the IMF has not made any official pronouncements about the exchange rate, Baunsgaard shares in the general approval of the recent adjustment in exchange rate policy, by which the kwacha has slipped roughly six percent against the dollar since the beginning of March. He said the GOM's apparent intent is to bring monetary policy into closer alignment with the official policy of a flexible exchange rate with seasonal smoothing interventions. This will almost certainly involve further depreciation over the next quarter or two.

## COMMENT: IMF HAS IT ABOUT RIGHT

¶6. (C) As reported earlier, the IMF's measured approach is proving useful on two fronts. It gives the Ministry of Finance good cover to argue for continued fiscal austerity, including in its approach to the food crisis. It also gives the donors a lever to argue against a massive commercial grain program, the traditional and almost always disastrous response to poor harvests. At this date, the donors and the GOM are still wrestling over how to address the coming humanitarian needs, but the discussion is mostly happening within the bounds of fiscal prudence.
GILMOUR